Rural Business Development – A Governance Assessment

Final Report

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Abbreviations

(in alphabetical order)

ADB Asian Development Bank

CRH Citizens Representative Hural

GI Gobi Initiative (Gobi Regional Economic

Growth Initiative)

GOM Government of Mongolia

MC Mercy Corps

MNT Mongolian National Togrog

MOJHA Ministry of Justice and Home Affairs

MPRP Mongolian People's Revolutionary Party

NPMA National Professional Monitoring Agency

OSS One Stop Service

PMD Professional Monitoring Division

SGH State Great Hural

TAF The Asia Foundation

TCI The Competitiveness Initiative

UNDP United Nations Development Programme

USAID United States Agency for International

Development

WB World Bank

Study and Document Overview

Purpose of Study. The Asia Foundation Mongolia (TAF) spent the past six weeks intensively assessing the role of rural government in rural business development. The purpose of the "Rural Business Development – A Governance Assessment" study is to best inform Mercy Corps and USAID about the theoretical and practical potential that local (rural) governments can play in supporting and enabling local (rural) business development in Mongolia today. The study consists of a legal analysis and a situational analysis, and strives to answer one core question: Are aimag and soum governments a factor in rural business development, and if so, how and in what ways?

The legal analysis outlines the legal and regulatory framework within which local government authority and decision-making operates, with an emphasis on authorities and decisions affecting rural business and the rural commercial environment. The situational analysis provides quantitative and qualitative assessments of how, in practice, rural governments exercise their legally vested authority, and the impact that such government decisions and actions have on rural business. TAF is confident that our rapid assessment and analysis will allow MC and USAID – as they design the second phase of the Gobi Initiative (Gobi 2) – to determine how best issues of local economic governance may be addressed (i.e., how rural businesses and rural governments may be engaged with the aim of improving the operating environment for rural business development in Mongolia).

Disclaimer. The Asia Foundation possesses more than 13 years of governance and economic reform programming experience in Mongolia, as well as significant institutional capacity and expertise, all of which was brought to bear on this rapid assessment. However, due to an unusually short amount of time to gather and analyze data and then deliver a useful report, TAF, as well as MC and USAID, knew from the outset that it would not be feasible to provide the breadth and depth of insights and analysis that TAF is accustomed to delivering. Moreover, and given such a tight timeframe, the inherent nature of this study and its findings are exploratory and informative, rather than exhaustive or definitive. Hopefully, these constraints have not diminished the quality, professionalism or utility of TAF's work. Rather, such a rapid assessment of how rural governments can effectively play a supporting role in creating an enabling environment for rural business development now is expected to lay a solid foundation for more comprehensive analyses, and interventions, that will allow the Gobi 2 project to design and implement the most relevant and results-oriented local governance programming possible.

Due to a large amount of data and a short amount of time, TAF needed to use multiple authors to draft and revise different sections of the report, a fact that renders the tone and style of writing somewhat varied at times. In order to present findings and conclusions in the most concise and coherent manner possible, TAF also decided to present the final report in two documents. The primary document (this one) includes an executive summary, key findings from the legal analysis and situational analysis, as well as conclusions drawn from the overall study.

Methodology. With merely five weeks to implement the entire study, analyze the results and submit a draft report, the methodology employed here was at times less than ideal, yet the results are both striking and informative. The legal analysis was

largely a desk study, and involved in-depth review of more than 50 current laws, as well as central and rural government resolutions, programs, decrees, provisions and regulations. The situational analysis consisted of three interlinked surveys designed to capture perspectives from and gather data about: rural businesses, rural government officials, and Ulaanbaatar-based third party experts and ombudsmen-type professionals. In all, 53 rural businesses (from Uvurhangai Aimag and Harhorin Soum) were surveyed (and data from 51 was analyzed), 15 rural government officials (from Uvurhangai, Bayanhongor, Govi-Altai and Govi-Sumber aimags, and Harhorin soum) were interviewed, and six third-party experts and professionals in Ulaanbaatar were interviewed.

Expanded Data and Analysis. The accompanying and supporting document, called Expanded Data and Analysis, includes complete data and narrative analyses, as well as appendices with all survey instruments, lists of institutions and individuals contacted and laws and policies consulted, and the original terms of reference. Finally, it is worth nothing that an especially useful tool for reading, using and cross-referencing the two documents is an expanded table of contents, or Index, that has been included at the beginning of the accompanying Expanded Data and Analysis document.

Executive Summary

The Asia Foundation conducted the rapid "Rural Business Development – A Governance Assessment" and produced this document in response to a request by USAID and Mercy Corps to answer the specific question: "Are rural governments a factor in rural business development, and if so, how and in what ways?" The short answer, in fact, is yes. But a more complete and useful answer requires a more sophisticated understanding of the structural relationship, defined by law, between central and local government. This legally-defined relationship *passively* provides authority to rural governments by not explicitly restricting local government initiatives. Similarly, wording in the legal framework often empowers the center but does not at the same time clearly state what local governments *cannot* do. Thus, in reality, the effective relationship between central and rural government is in fact defined by great distances, poor communications, and only *reactive* restraint by higher-level government institutions.

In this context, the role of local government institutions and officials in Mongolia must be understood in terms of authority and autonomy. Authority (which *can* create opportunities for autonomy) can be considerable in terms of the official functions expected, such as public service delivery, local law enforcement and numerous types of inspections at the business site. Autonomy meanwhile emanates from opportunities created by vested authority as well as from ambiguities in the legal and structural relationships. This study suggests that local governments could do more to create a business-friendly environment for rural businesses. A key to such change is public sector officials in rural communities better understanding not only the pressing needs of local businesses, but also the range of actions within its power as defined either by official authority or effective autonomy.

What is apparent from the study's legal and situational analyses is how the "siloed" nature of government agencies and departments at both central and rural levels precludes integrated communications and strategic thinking and planning. It is clear that central government agencies, operating independent of one another, regularly solicit all kinds of information from their rural government counterparts, largely through official needs assessments. This information is directly used to inform new central government policies and programs (of which there are at presently an overwhelming 93). These programs and policies (and the allocated budgets that go with them) are in turn passed back down from central to rural government. So, although the legal framework, and the resources allocated to operate within it, comes from central government, it is *ultimately determined and shaped largely by information and input provided by rural government*. In other words, the ball is in rural government's court.

What is not clear is the degree to which rural government sees the potential power it possesses to influence the nature of these government programs, policies and respective budget allocations. The research indicates that rural government agencies and departments are not integrating their internal communications and responses to central government's needs assessments. Rather, they operate like silos. And beyond this lack of horizontal integration among siloed rural government agencies and departments, research shows a lack of strategic thinking and planning by rural government *before* it even responds to central government requests for input.

The Rural Business Development – A Governance Assessment study concludes that rural governments are not horizontally integrated, internally, in terms of communicating and responding to central government's requests for input. Rural government moreover thinks and acts in passive, reactive ways, and not in strategic, pro-active ways. And yet when rural government *does* react to central government's regular requests for input, it does so without having solicited the priorities and needs from the rural business community.

Perceived and real barriers to communication and understanding within rural government — and between rural government and rural business — are preventing rural government from thinking and behaving more strategically when responding to central government requests for input. A failure to think and act strategically, in turn, perpetuates these same barriers, ultimately preventing rural governments from doing more to empower themselves and hence to improve local operating environments for rural businesses. In sum, any official authority and effective autonomy that rural governments have, and hence that rural businesses could benefit from, is being hindered as a direct function of these barriers.

Key Findings from the Legal Analysis

Constitutional Arrangement of the Government

As the Constitution provides, the territory of Mongolia is divided administratively into aimags and the Capital city; aimags shall be subdivided into soums; soums into Baghs; the Capital city shall be divided into Districts and Districts into Horoos. (Article 57.1)

Candidates for Governors are nominated by the hurals of respective aimags, the capital city, soums, districts, baghs and horoos. Governors of aimags and the capital city are appointed by the Prime Minister; soums and district Governors by the Governors of aimags and the capital city; Governors of baghs and horoos by the Governors of soums and districts respectively for a term of four years (Article 60.2). (See for the Government structure Graph 1 below).

The Constitution affirms that only the State Great Hural may define economic policy and ultimately may make economic decisions in the country. This principle is reflected in other laws, including the General Tax Law, Article 4 of which states that: "The State Great Hural shall create, change or annul a tax by adopting a law. The percentage and size of the tax shall be established by the State Great Hural or with its approval, by the Cabinet, or by the Citizens Representatives Hural of an aimag or the capital city."

In fact, in all aimags, key government agencies, including the tax department, are administratively separate from the aimag government. They receive their budget directly from Ulaanbaatar and their heads are appointed by national agencies "in consultation with" aimag governors.

Central vs. Local Government

There are certain responsibilities that are divided between the central government and local governments. The Mongolian Constitution provides that Mongolia is a unitary state and, as such, the central government possesses exclusive powers to determine economic policy for the country. The principle of self-government for local self-governing bodies, or locally-elected Hurals, by law must be "combined" with central government. Such combination is described and prescribed by law through:

- consultations between local Hurals and the higher level governor (e.g., to appoint a soum governor, the soum Hural shall consult with the aimag governor);
- decisions made independently but in conformity with the Constitution, and if respective superior state organs do not specifically deal with definite local matters;

However, certain laws and programs adopted by the SGH provide broad and unspecific "powers" to local governments, including aimag, soum, capital city and city districts (both CRH and governors), that have direct relevance to the ways in which aimag and soum governments are a factor in rural business development. A significant portion of the laws, programs, regulations and provisions surveyed and studied were adopted within the last three years, a sign that the incumbent State Great Hural (SGH) and government (Cabinet) are keen to fulfill their 2000 election

campaign platform and subsequent action plan. One of the key tasks outlined in that action plan is to improve the legal and regulatory environment for conducting business in Mongolia.

It is clear from this study's legal analysis that these powers clearly empower Citizens Representatives Hurals (CRH) and aimag and soum governors with the authority, and responsibility, to make local decisions and take local actions regarding local business activity. In fact, on a number of occasions the central government is required to consult with local governments (e.g., when issuing special permits) before acting.

Law on Administrative and Territorial Units and their Management

This Law, which further regulates local governments, was first adopted in August, 1992 and subsequently amended in 1996 and 2000. According to Article 8 of the Law, "The main management principle of administrative and territorial unit is the combination of self governance and the state management. Based on this principle, the local management shall independently coordinate economic and social issues on the constituent territory".

Following is the number of members set for local CRHs (in Article 9-1):

Aimag population	Number of CRH members
Up to 50,000	25
Between 50,000 and 90,000	30
90,000 and more	35

Soum population	Number of Hural <u>Members</u>
Up to 2,000	15
Between 2,000 and 9,000	20
9,000 and more	25

In the Capital city	40
In Baganuur, Bagakhangai and Nalaih districts	15
Other districts	35

¹ Emphasis added.

The Government Structure (Graph 1)

The Legislature	The Executive Branch	The Judiciary ²
National level Parliament (Ih Hral)	Prime Minister & Cabinet	Supreme Court (all 18 judges) The Review Instance
Level of aimag or Capital city Aimag or one Capital City Citize as' Representatives	Governor	The Administrative Chamber (6 judges) of the Supreme Court The Appeal
Level of soum or District Citizens' Representatives Hural	Governor	Aimag or the Capital city Administrative Court The First Instance
Level of Bagh or Horo General Meeting	Governor	Hural proposes candidates for Governor. Prime Minister or respective Governor appoints lower-level Governor. "Self-governing bodies"

² The Administrative Courts will be functioning starting from June 1, 2004. The President of Mongolia appoints all the judges based on proposal of the General Council of Courts (Article 32.1, the Law on Courts)

According to Article 10.5 of the Law, "while implementing decisions of local CRHs, governors shall report to higher instance Governors."

Article 11 of the Law provides that local CRHs can discuss and decide any issue regarding "the life of the territory," except those belonging to jurisdiction of higher instance CRHs or other organizations. These issues may include:

- the status of economic and social development of the territory, its future trends; and
- the budget and financial activities of the local government, and related reports.

Governors of aimag, the capital city, soum or district have the power to (Article 14):

- submit reports [to the local CRH] on future and annual trends of economic and social development of the territory, and the draft budget of the government;
- implement approved plan and budgeted actions; and
- take measures to implement financial, monetary and taxation policies in the territory.

How Local Governments Regulate Local Businesses

Business entity registration:

The Law on State Registration of Legal Entities that was adopted in 2003 regulates the issue of registering legal entities. According to the Law, business entity registration is handled by local branches of the National Tax Departments in the aimags. Three different registration processes are to be followed: (i) for companies and other business entities (sole proprietorship, partnership, cooperative, etc.); (ii) for a personal income tax payer (including herders); and (iii) those who are irregularly involved in business activities.

A package of necessary documents shall be submitted to the Tax Offices, including:

- application for registering company or business entity;
- the Charter (Bylaws) of the company or business entity;
- feasibility study for setting up the business;
- introduction of owner(s); and
- formal declaration of the owner(s) to set up the company or the business entity.

Business Entity Registration Fee:

According to Article 13 of the Law on State Stamp Duty³, the fees for registering business entities are set as following:

- a company or partnership 10,000 MNT;
- a cooperative 6,000 MNT;
- sole proprietorship 5,000 MNT;
- a bank or insurance company 20,000 MNT;
- for changing business registration 1,000 MNT; and
- for re-issuing a business registration certificate 1.5 times of the above mentioned fees

Registration of Informal Business Owners:

A special Law titled "Income Tax of Citizens Running a Private Business Whose Income is Not Possible To Determine At Any Given Period" provides in its Article 6, the rules to register these "informals."

- Citizens engaged in 15 different small businesses, mostly street vending, can pay a monthly flat tax ranged between 200 MNT (for shoe shining) and 25,000 MNT (for changing foreign currencies) to the local tax office and get a monthly registration and certificate:
- Citizens engaged in other 17 types of services (Article 5.3), for example, driving taxi cab, can pay 10,000 MNT in advance to the local tax office and to get the monthly registration and certificate; and

The registration and certificate have to be renewed each month by the local tax office. The certificates are sometimes unofficially called "patent" and accordingly the informals are referred as "patent holders."

Inspections of Businesses and Legal Grounds for Such Inspections:

Inspections to be carried out by the State Great Hural, the President, the Constitutional Court, other courts, the Prosecutor's Office and the State Auditing organization are regulated by respective laws (Article 3.1, Law on State Monitoring and Inspection). Inspections or professional monitoring to be carried out by state administrative organizations, i.e. the Government (Cabinet), ministries, agencies, governors of aimags,

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³ Cash payments made by a legal entity or individual to a respective government organization or court for services provided is called as state stamp duty. Services may be provided with respect to issuing permits, registering or granting documents in relation to the transfer of rights, certifying contracts, agreements and other documents, registering documents of citizenship, or resolving disputes (by courts) (Article 3, the Law on State Stamp Duty).

the capital city, soums or districts, and by local self-governing bodies, shall be regulated by the Law on State Monitoring and Inspection (Article 3.2).

Inspections may be carried out based on:

- the inspecting organization's or official's own initiative;
- the instructions of higher instance organizations; or
- other grounds provided by law (Article 5.1).

Local government has the power to conduct inspections in following areas:

Inspection Role of Aimag or Soum Governors:

This is a general description of a governor's obligation to inspect local businesses (although inspection of the enforcement of a specific law is usually regulated by the specific law itself):

- Enforcement of law and legislation in the constituent territory (Article 15.4, Law on Administrative and Territorial Unit and Its Management and Article 8, Law on the State Monitoring and Inspection);
- Exploitation and protection of subsoil (Article 7.2.3, Law on Subsoil);
- Payment of mining or extraction fee by a mining license holder to the local budget and his/her actions with respect to protecting the nature and environment and ensuring the health and safety of workers and residents (Article 6.4.3, Law on Minerals); and
- Preparation works for winter and spring conducted by herders, citizens or business entities that own livestock (Aricle 3.9.9, "National Program to Assist the Protection of Livestock from Draughts and Zuds⁴" approved by the Government (Cabinet) resolution number 47, dated March 13,2001.)

Professional Monitoring Division Inspectors:

Other officials who have the power to inspect the enforcement of special laws are PMD inspectors. Resolution 37 of the Government (Cabinet), dated March 13, 2003, has provided the "General Charter of the National Professional Monitoring Agency." The Charter lists the areas of jurisdiction where both national and local professional monitoring entities shall carry out inspections (Article 2 of the Charter). These are:

• Finance (monitoring and auditing of the government budget organizations) (Article 2.1);

⁴ Zud is a Mongolian word for excessive drought followed be severe, and disastrous, winter weather.

- Insurance (Article 2.2);
- Social welfare (Article 2.3);
- Health and oncology (Article 2.4);
- Drugs and bio-medical preparations (Article 2.5);
- Health treatment quality (Article 2.6);
- Labor (Article 2.7);
- Education, entertainment and science (Article 2.8);
- Radiation (Article 2.9);
- Nature and environment (Article 2.10) (also regulated by Article 27.1.2, Law on Nature and Environment Protection);
- Geodesy and topography (Article 2.11);
- Standardization and product quality (Article 2.12);
- Measurement (Article 2.13);
- Building technology (Article 2.14), (also regulated by Article 18. 2, Law on Construction);
- Roads (Article 2.15);
- Energy (Article 2.16);
- Information and communication (Article 2.17);
- Tourism and travel (Article 2.18);
- Transportation (Article 2.19);
- Geology and mining (Article 2.20);
- Production, services and trade (Article 2.21);
- Food production and its technology (Article 2.22);
- Veterinary services (Article 2.23);
- Breeding program for livestock and other animals (Article 2.24);

- Plant protection and quarantine regime (Article 2.25); and
- Seeds and variety of crops (Article 2.26).

Inspectors in charge of each area, although work and reside locally, are selected and appointed by the central authority (NPMA in Ulaanbaatar). Both the aimag government and the center control and supervise their actions.

Licenses and Permits:

Aimag governors may issue one of the following five special permits:

- Running inter city or inner city public transportation services (Article 16.2.1);
- Professional activities of health organization (Article 16.2.2);
- Production, import of and destroying poisonous or less poisonous substance (Article 16.2.3);
- Setting up a (primary, intermediate or high) school (Article 16.2.4); and
- Sale of and serving with alcoholic beverages (Article 16.2.5).

Soum governors may issue one of the following three special permits:

- Running production or use of stationary sources of power that release polluting substance in the air or negatively affects physiology of human being (Article 16.3.1);
- Running public transportation in the local area (Article 16.3.2); and
- Setting up kindergarten (Article 16.3.3).

Local Government's Role in Providing Support to Local Businesses and the Use of Local Budgets to Provide Such Support

Article 6 of the Law on Administrative Units provides that aimags, the capital city, soums and districts shall have their own budget.

The types of the budget income, classification of expenditure, financial allocation as well as the budget allocation, adoption and accounting are regulated by the Law on the Consolidated Budget (hereinafter Budget Law) adopted on November 20, 2002.

Aimag Government budget revenues come from:

- Use of mineral resources (Article 10.1.2, Budget Law);
- Land fees (Article 10.1.3, Budget Law);

- Immovable property taxes (Article 10.1.4, Budget Law);
- Taxes for means of auto transportation or other vehicles (Article 10.1.5, Budget Law);

Aimag governments can also generate the following non-tax revenues:

- Dividends from fully or partially local government-owned businesses (Article 10.2.1, Budget Law);
- Proceeds from sales or lease of local government property, or from fines and interest accrued (Article 10.2.2, Budget Law);
- Funds to finance products to be ordered by relevant budget administrators (Article 10.2.3, Budget Law); and
- Other revenues allocated to the aimag government according to laws and legislation (Article 10.2.4, Budget Law).

Daily transactions of government revenues and expenditures shall be carried out through the State Treasury (Article 14.1). If local budget revenues and expenditure cannot be balanced, then necessary assistance (subsidy) may be provided by the national government (Article 14.4). The Treasury management shall make sure that all the local tax revenues are channeled back to the local governments to finance the proposed "procurement" of products and services from local entities.

In preparing to adopt the new Law on Management and Financing of Budget Organizations (discussed below), a consolidated nationwide Treasury has been set up under the direct management of the Ministry of Finance and Economy according to Government (Cabinet) resolution 101, adopted on May 24, 2002.

Use of the Government Budget to Support Local Economic Development:

The new Law on a Consolidated Budget of Mongolia provides that allocation, financing, expenditure, performance and reporting of the Government budget shall be regulated by the Law on the Management and Financing of Budget Organizations (Article 11.1). Adopted by the State Great Hural on June 27, 2002, the Law on Management and Financing of Budget Organizations (often referred to in English as a public finance act) has introduced a revolutionary approach in terms of improving the efficiency, economy and effectiveness of using government resources. This approach is based, first of all, on the notion that government entities will supply to products to the government.

According to the Law, the local Citizens' Representatives Hurals have the following powers with respect to local budgets (Article 50.1):

- discuss, approve and monitor action plan and long term plans of respective Governor;
- discuss, approve and monitor of the implementation of the local budget for the given year;
- establish and approve the amount of products to be purchased from the local budget and reach an agreement with the Governor and ensure its implementation;
- review the draft agreement on supplying products by the Governor beforehand and comment on numbers, amount, costs of the products and on conditions and procedures for evaluation of the products;
- establish procedures regulating management and financing of fully or partially local government owned legal entity based on principles and norms of relevant laws; and
- exercise its power to spend the Citizens' Representatives Hural's own budget.

Governors of aimags, the capital city, soums or districts have the following powers (Article 51.1):

- develop action plans and long term plans;
- develop draft budgets;
- guide activities of local budget entities in accordance with the Citizens Representatives Hurals' approved action plan and long term plan;
- define the need for products to be purchased from others and reach an agreement;
- ensure usage, protection and safety of locally owned property, select and appoint managers of local budget entities and enter into performance contracts; and
- monitor supply of products specified by the performance contracts and financial results.

Obligations and duties of the governors of aimags, the capital city, soums and districts are regulated by Articles 52, 53, 54 and 55 of the Law on Management and Financing of Budget Organizations. Article 27.1 of the Law provides that government entities have to submit their next year's draft financial plan and budget draft to the respective budget administrator before July 1st of each year. The budget administrators then shall submit the integrated budget to the Ministry of Finance and Economy before August 15th. The Ministry shall review all the draft budgets and submit to the Cabinet its integrated draft September 15th (Article 31.1). The Cabinet in its turn shall submit the whole document to Parliament by October 1st, after reviewing the content of the proposal (Article 32.1).

The State Great Hural shall discuss and adopt the integrated state budget by December 1st of each year (Article 34.1).

The Supporting Role of Local Government:

According to Article 14.1.6 of the Law on Administrative and Territorial Unit and Its Management, aimag and soum governors have the "power" to <u>support contracting</u> between businesses⁵ and to ensure that the contracts are enforced in order to improve supply of food and products of general consumption for the population in their constituent territories and to increase production and supply of products and raw materials.

According to Article 14.1.7 of the Law on Administrative and Territorial Unit and Its Management, aimag and soum governors have the "power" to <u>support manufacturing</u>, <u>services</u>, <u>barter trade and general trade⁶</u> in their constituent territories. According to Article 18.3 of the Law on the Legal Status of Towns and Villages, mayors of towns or villages also have the general "power" to <u>support production and services aimed at serving the needs of residents⁷</u> in the particular town or village.

According to the Government Program on Improving Livelihood of Households, approved by Resolution number 108 of the Cabinet in May 10, 2001, the aimag and soum governments may run a loan scheme to businesses that generate jobs and revenues for the local government (Article 13 and 14 of the Program). As Article 27.1 of the Program states a part time Council shall be set up under the chairmanship of the local Governor in order to monitor implementation of the Program in the local area.

The Law on Supporting Employment:

In April 2001, a legislation titled "Law on Supporting Employment" has been passed by the Parliament. The Law prescribes three different actions for both the central and local government (Article 5.1, the Law on Supporting Employment):

 Services supporting employment 	ent	l.
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⁶ Emphasis added.

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⁵ Emphasis added.

⁷ Emphasis added.

- Measures supporting employment;
- Disbursement of unemployment benefits.

Employment support activities have to be coordinated by a part time Council of three entities: the Government, the Employers Association and the Trade Unions (Article 20.1, Law on Supporting Employment). In addition, the Government has an entity titled "Central Authority of Employment" and similar entities/subsidiaries have been created in each local governments. Functions of such entities are (as provided by Article 21.4 of the Law):

- Enforcement of law and legislation on employment, planning of supply and demand of labor market and defining its trend;
- Reduction of unemployment through development of labor market policy and development of work force;
- Studying and analyzing employment situation and creating information network on labor market;
- Disbursement of funds from the Employment Support Fund (which is to be created by the same Law and financed at least by 0.3 percent of the central Government budget and by other contributions as provided by Chapter IV of the Law), monitoring and reporting on the activities of the Fund;

Local governments shall provide support to:

- Citizens who are running businesses as sole proprietorship, partnership or cooperative member; and
- Employers.

In order to implement the functions, government entities (including local governments) shall take the following measures (Article 5.2, Law on Supporting Employment):

- Providing direction regarding [available] jobs, advice and information;
- Interlocutor and mediation services (between employers and job seekers) in order to facilitate employment;
- Vocational training and re-training for unemployed people; and
- Other services as provided by law.

The disbursement of funds from the Employment Support Fund, mentioned above, shall be used for following purposes:

• Small loans to support small businesses and cooperatives (Article 10);

- Reimbursement of salaries to employers that have employed, for six months or longer term, a citizen who had been previously unemployed for more than one year term, 60% of six months' salary that was paid to the employee shall be paid back to the employer (Article 11.1).
- Reimbursement of training costs provided to a previously unemployed employee by his/her employer who has provided the training plus a job for longer than three months (Article 11.2);
- Reimbursement of salaries to employers that have continuously employed, a citizen who could be unemployed. Forty percent of three months' salary paid to the employee shall be paid back to the employer (Article 11.3);
- Providing direction regarding [available] jobs, advise and information (Article 15.1.1.a);
- Mediation to provide employment (between employers and job seekers) (Article 15.1.1.b);
- Vocational training and re-training for unemployed (Article 15.1.1.c);
- Training of self employed individuals engaged in small business, in programs that aim to improve their business skills (Article 15.1.1.d);
- Organization of public works (Article 15.1.1.e); and
- Supporting sole owners of business and citizens joined cooperative or partnership.

Regional Development Plan:

A regional development plan concept document was adopted as Attachment 1 to Resolution number 57 of the State Great Hural, dated June 14, 2001. The document points out that aimags possessing 92.1 percent of the nation's territory, 89.6 percent of animal population, 80.7 percent of fresh water reserve and 73.4 percent of the forest reserve are not truly covered by market reforms, and remain behind the developments taking place in central areas.

The document also states that: "It is not possible to ensure economic independence of aimags and soums solely based on their internal resources, and distribution of the state funds to numerous and small administrative units is proven to be ineffective as witnessed by past lessons and the current situation of the market economy." Therefore, the regionalization plan has been designed in order to "set up a system of support to development of local economies."

According to paragraph 2.3.2 of the concept document, "each aimag and soum shall correctly determine the main direction of their business activities within the respective

region, shall create a business environment for coordinated development of the aimags or soums and. . . . shall ensure stable increase of economic growth and efficiency."

Local area or urban centers which are influential and have potential for future development shall be considered priority areas and developed first with an assumption that these areas or urban centers will then assist other areas of the region (paragraph 3.5).

Aimag and the capital city government (including the CRH and administration) shall work together with businesses and citizens to coordinate its efforts to resolve common issues of development for the region including the selection of production and services able to compete in the market, coordination of business activities and infrastructure in the area (paragraph 3.14).

Following industries shall be commonly developed within each region (paragraph 4.4):

- livestock farming;
- light manufacturing;
- mining extraction and processing;
- construction and construction material manufacturing;
- production and services requiring intellectual capacity;
- tourism and sanatoriums;
- infrastructure for production and social services; and
- market infrastructure components.

However, based on the specifics of each region, different industries shall be developed as priority industries. For example, in the Hangai region, to which Uvurhangai belongs, the following industries were given priority (paragraph 4.5):

- pastoral livestock farming;
- crop growing;
- tourism, sanatorium;
- small and medium enterprises;
- mining extraction and processing; and
- timber processing industry.

In May 30, 2003 the State Great Hural adopted the Law on Management and Coordination of Regional Development. The Law provides basic principles of regional development management and coordination of development efforts among respective aimags and soums per region.

The National Program to Support Cooperatives

The Government (Cabinet) by its resolution number 255, dated December 23, 2002 has adopted the National Program to Support Cooperatives by declaring year 2003 as "a year to support cooperatives." The program envisions following measures to be taken throughout the year 2003:

- improvement legal environment for cooperatives;
- increasing the effectiveness of the government organizations to support cooperatives;
- extending training programs and information services for cooperatives;
- supporting cooperatives associations; and
- intensifying works carried out by local governments to support cooperatives.

The program has a component that will provide loans to cooperatives, though it does not state how much will be available for this purpose. The program will conduct a contest among existing cooperatives that will select the best 10 cooperatives and award each of them with one million MNT. It will also provide training among 300 trainers in 17 aimags who will then train cooperative members in these respective areas.

Key Findings from the Situational Analysis

Perspective from Rural Government

The findings from interviews with rural government officials indicate that rural governments are struggling to improve their own capacity to support and make a positive impact on rural business development with the limited resources they have. A constraint on rural government performance was identified by a number of respondents, who admitted that many officials lack the know-how and skills to support rural businesses. This is in part because rural governments have no historical precedent for creating enabling operating environments, and in part due to officials' own lack of theoretical and practical knowledge about market economics and free enterprise. Government interviews rarely uncovered serious efforts to shape significant local government activities to respond to priorities identified by the private sector.

Tax was a big issue, and all of the government officials surveyed were of the opinion that not a single business is paying the correct amount of tax. This opinion was shared by officials in the rural tax office. Tax evasion was one of the areas rural government felt was having the biggest impact on their relationship with rural business, yet it was the thing they felt least empowered to change due to lack of resources. Rural governments also perceive that they would be better placed to respond to the demands of their constituents if they had control of their own revenues.

When asked about their own current initiatives to promote rural business development, rural government officials surveyed said that recent changes, simplifying business registration, permit allocation and the inspection process have greatly improved the efficiency and quality of those services. Several officials mentioned the SME business loan initiative or the reimbursement of 60% of the first six months of new employees' salaries to employers. These initiatives and others are taken from the central government programs and resolutions. (See the section in the legal analysis section above on the Law on Supporting Employment for more information).

In general conversation with the government officials on the subject of how they were overcoming the limitations imposed by the policies and financial resolutions they had to implement, a few surprising local "initiatives" *did* surface:

 A PMD official admitted that the inspectors only required a 60% pass rate for their business inspections. "If it were much higher, there wouldn't be any SME businesses left in the aimag!," he said. "So we then work with them through repeated visits to ensure they are improving."

- One higher-ranking official said, "We often grant a permit to a business prior to actual compliance with all necessary requirements. This is so we don't unduly restrict the business' operations due to bureaucracy."
- Several rural government officials confidentially revealed that rural governments are deliberately underestimating their revenue targets in their budget predictions to the central government. This way, at the end of the year, the aimag can then show over-delivery in their tax revenues, whereby central government will 'reward' them for over-delivering on their prediction of tax revenues by increasing central government's top-up to the aimag. This practice (based on interviews with rural government officials) appears to be well known and understood by central government, and is used as one method of increasing the top-up within its limited ability to alter allocations to aimags.

The examples above show that rural governments are in fact affecting things at the rural level, even though they say there is little they can do with what little resources they have. The methods rural governments currently employ seem limited to the actual central government programs and policies in place, and there were few example of local governments working in areas *not* covered by existing programs and policy.

There were no examples given of rural government actively soliciting information from local businesses regarding their priorities, but it was noted that the businesses who complain the most about lack of government services and support were said to be the ones most fervently avoiding taxes. While the accuracy of this claim could not be tested, it reveals both an avoidance of the question at hand and an underlying hostility towards private sector troublemakers who might make demands of their local officials. Indeed, some officials remarked that they had little or no experience in how to interact with business. Moreover, the survey reveals the fact that very few local government officials see it as their responsibility to respond to the needs of the private sector.

To quote some examples of rural government officials' comments on their understanding of the needs and priorities of the business community:

- "We make inquiries about what types of products are to be produced, and about the estimation of taxes (from local businesses) to be paid to the budget."
- "We can anticipate the needs of businesses, as it is primarily the issue of infrastructure (e.g., power, good roads)."
- "We already provide favorable conditions to the businesses when devising the budget."
- "Businesses carry out their business independently of government."

• "Businesses usually look for tax concessions, but according to the law we cannot change this, as tax rates are not set by the aimag."

Initial analysis of findings from the surveys of rural government, rural business and third-party experts in Ulaanbaatar indicates that poor communications between rural government and business is a real barrier to an improved operating environment for rural business development. Survey data moreover reveals that the relationship between rural government and business exists at little more than a functional level, with perfunctory interactions the norm. However, these findings and related analysis seem largely driven by perception, which may in certain instances be consistent with reality, but which does not tell the whole story.

Breakthrough: Perceptions vs. Reality

The perceptions indicated by aimag governors, government officials, businesses and the third-party experts from Ulaanbaatar, all seem to suggest and support the notion of rural government situation as a struggling middleman burdened by policies and resolutions with severe financial constraints. Rural government officials feel *restricted* in their current situation, and unsatisfied with the extent to which their official authority and effective autonomy allow them to maneuver, and to do better work in supporting rural business development. To be sure, it seems clear that the central government (Cabinet), through its resolutions and specific procedures adopted by its respective ministries, sometimes directs aimag and soum governments, and governors, in ways that do not leave much room for maneuvering or innovation.

The initial findings of this survey, described above, at first confirm this view. It was only after completing our draft document (submitted to Mercy Corps on October 17, 2004) that it become apparent that there was a need to revisit our conclusions based the origins of the rural governments' main concern: their lack of authority when it came to the procedures and resolutions passed down from the central government. Important follow-on questions then had to be asked: "Where do all the programs and resolutions start, and from whose initiative? Towards what vision, and based on whose needs and objectives do all the government programs and resolutions come from?" With these questions in mind, the TAF team worked through the data again until a new understanding of the rural government-central government relationship came to light. Confirmation of this "new" understanding came from phone conversations with government officials who had been previously interviewed with follow up questions to the original survey.

What has now come to light is that rural governments are in fact "burdened" by various needs assessment surveys coming down from the central government, created by and related to each separate (and uncoordinated) government department and division. These assessments cover the whole spectrum of government concern and are deemed a less-then-useful inconvenience by rural government officials, who describe the following sequence of events as characterizing reality:

- 1. The central government departments survey the rural governments to assess their needs
- 2. The needs assessment surveys are analyzed by the central government and from the results create new programs.
- 3. The programs are handed down to the rural governments to implement
- 4. Rural governments produce a budget based on fulfilling the requirements of the programs and submit it to the central government.
- 5. The central government produces financial resolutions based on the aimag budget and passes them back to the aimag governor.
- 6. The aimag governor attempts to implement the programs created from the needs assessment surveys using the financial resolutions created from the aimag budget he submitted.

The above process is described in the diagram Figure 2 below.

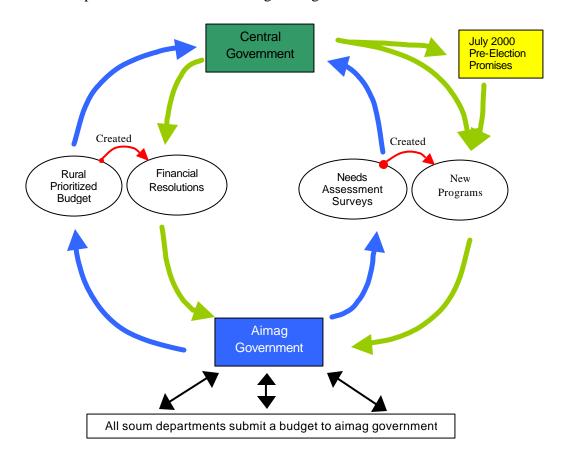


Figure.2: Origin of programs and resolutions

In an effort to confirm that this is what should be happening according to law, TAF's legal analyst reviewed all the government programs created since the new government came to power (after the 2000 elections). And while it is clear that central government solicits the needs of rural governments, it is not clear to what extent subsequent government programs are shaped by those needs assessments vis-à-vis central government's pre-election promises. An area for further investigation might be to look closely at the various needs assessments coming from central to rural governments, what needs rural governments identified, and then the actual government programs that followed.

Another influential contributing factor to the dissatisfaction by rural governors of the financial resolutions passed *back* to them, is the "silo" each rural government division effectively sits in (which, in fact, seems mirrored by corresponding silos within central government). When the budgets are produced for each division, there is virtually no communication between divisions on the priorities of the aimag as a whole. This is confirmed by the following example.

While searching through last year's financial resolutions for one aimag, the TAF team found a local budget line item for a small bridge to be repaired at a cost of 10,000,000 MNT, out of a total budget of 70,000,000 MNT. This activity was selected for investigation to see why it was chosen and what significance its repair was to the aimag to warrant such a large allocation from the annual budget. After a subsequent telephone conversation with the respective aimag governor (who had previously been interviewed), the TAF team learned that, in fact, the bridge in question has little significance. The only reason the repair of this bridge was in the central government's resolution document, and hence in the aimag's annual budget, was because it was submitted by the aimag government's infrastructure and roads department without consultation with anyone else (including the aimag governor). "This kind of thing often happens" the governor said. "I am then left with (an undesirable) resolution and corresponding budget, or the task of taking it up with central government to try and get it amended."

The TAF team then contacted the head of the infrastructure and roads division from the above example, who explained that each soum governor submits a budget to him, which contains hundreds of recommendations for infrastructure and road repairs *per soum governor*. In total, there are literally thousands of requests from the soums, which the division head of infrastructure and roads must then somehow prioritize, seemingly in isolation. This becomes an impossible task and in reality what happens is an almost random selection of requests from soums that are included in the main budget so as to cover the revenues allocated to that division, all in hopes that the funds can somehow be divided up and used differently once the money arrives.

In sum, the initial perception gained from nearly the entire survey sample originally interviewed – that rural governments can better empower themselves by communicating better with rural businesses – is true but incomplete, and hence flawed. The whole story must include the fact that rural governments today are in

fact empowered, not only to help decide which programs are given to them, but also to control how their finances are allocated in those central government resolutions that they will then implement, and that will directly impact, or not, rural business development.

Key Findings from the Situational Analysis

Perspective from Third-Party Experts and Ombudsmen Professionals

This component of the study stood out from the others, as it focused on eliciting facts and opinions from Ulaanbaatar-based experts and professionals. Most of these respondents are long-term expatriate residents in Mongolia working for international donors and aid agencies, development projects, or foreign embassies. A number of these respondents, through their work, have considerable experience working on private sector development initiatives, and in dealing with issues and conflicts related to local economic governance. However, and despite being interesting sources of opinions, the information elicited from third parties was largely based on perception and not hands-on, first-person experience. Most of the knowledge and information gleaned from these respondents tended to be anecdotal. Moreover, the vast majority of respondents possessed far more knowledge of, and experience in, Ulaanbaatar than in rural areas. Therefore, there were few if any 'key findings' to directly inform the analysis and conclusions of this study⁸. However, two respondents provided useful and relevant real-life examples of how rural governments are a key factor for rural businesses.

The first example comes from an expert in Mongolia's tourist industry, who told of two rural tourist ger camps near one another. Rural government inspectors came to both camps. The first camp inspected had used foreign investment to install modern, 'eco-friendly' toilets using the latest technology. But because the camp's description of these toilets used the word 'chemical,' this camp failed the inspection, incurred fines, and was told to remove these eco-friendly toilets. Meantime, the other camp, which was found to be flushing all wastewater from its toilets directly into a nearby river, which served as the local water supply, passed the inspection.

The second example comes from a rural agro-business development expert, who explained how public veterinary service providers are required to produce annual budgets for materials and medicines required for the upcoming year. Not only is this unreasonable given the unpredictable nature of animal diseases and their propagation, but it causes delays in the planning process for procuring and supplying needed materials and medicines. These supplies therefore tend to arrive subsequent to when they are most needed to prevent and control animal diseases (this of course assuming that the public veterinary service provider in question was able to correctly predict the proper type and amount of materials and medicines needed in the first place!) The negative impact of this out-of-synch supply chain and related delays in procurement is exacerbated by poor communications and transportation infrastructure in rural areas, as well as by vast distances between and among herders and their herds. The overall effect of this problematic situation is a reduction in the quality of the end products for sale, i.e. skins, hides, cashmere, meat and dairy – the production and sale of which constitutes the majority of rural business and commercial activity in Mongolia.

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⁸ To see complete answers and analysis from the six third-party interviews, please see the Expanded Data and Analysis section (attached).

Key Findings from the Situational Analysis

Perspective from Rural Business

To understand the structure of relationships between government institutions, conversations with a variety of public officials working at various levels of government are a critical source of information. However, understanding how well the functions of economic governance are being fulfilled requires a different set of conversations, not with those making and implementing decisions, but rather with those whose lives and livelihoods are affected by those decisions. With this in mind, a survey was undertaken of the business community in Uvurhangai to assess the functioning of rural government vis-à-vis rural business. This section presents the key findings of that research.

The questions on the quality of service delivery by the local government yielded some interesting insights. First, the majority of all local businesses responded that public services actually impact their businesses – on average 68% of small businesses and 63% of larger businesses reported that a local government service had a direct impact on its commercial activities. Second, smaller businesses tended to be more critical of government service delivery, and this result held true even if the statistics were calculated to include only businesses affected by the service in question. The following public services are the responsibility of local government.

Police: Law Enforcement and Security Services. The community police force represents an important institution for the local business community. When it is functioning properly, the police provide protection and security, not just from theft, but also from illegal or improper conduct by competitors. But the authority placed in police forces to play this role also creates opportunity for misconduct. One of the most striking results from this section of the survey was the perception of the small business community to the police force. More than two out of every five small businesses (42%) rated the force as very poor or inadequate, and of the businesses that report significant interaction with the police that impacts their businesses (roughly half of all small businesses), the negative rating reached almost two-thirds of the sample (about 65%).

Dispute Resolution. The degree of legal certainty in a local environment is determined not only by the practices of the police force, but also by the functioning of public mechanisms used to resolve commercial disputes, such as the fulfillment of contractual obligations. This issue turned out to be one of broad agreement between the communities of larger and smaller business communities – both rated the performance of this function very low, and for larger businesses, this public service received the second worst rating of all public services. Seven out of ten of the larger businesses that reported that the dispute settlement system affected their business reported that the quality of the service was very poor or inadequate, and not a single one of these businesses reported a score higher than "adequate." Similarly, more than half (52%) of the community of smaller businesses rated the quality of these serves as inadequate or very poor.

In addition to services, such as those described above – that are essentially provided passively to the entire business community – businesses are often required to actively

engage with government institutions to request actions that are required by law, such as the acquisition of various licenses and permits. The manner with which government agencies and their officers discharge this function can either contribute to the emergence of a dynamic business community or discourage this desired dynamism. Important factors include both the complexity of the process, which can lead to long and difficult involvement by the entrepreneurs, and the financial cost of the process, both in formal and informal fees that are demanded by the officers in charge.

The survey solicited feedback regarding the experience of the business community in their attempts to obtain eight different kinds of licenses. The research results show that large businesses must wait a longer average period of time for permits then small businesses. In addition, large business must pay larger amount of informal payments then smaller business for gaining access to these permits. These delays reflect a real failure of economic governance, as they drive up costs and discourage new investment. The research does not determine the factors for delays, and businesses may sometimes themselves be responsible, but when an operating environment is characterized by repeated difficulties, ultimately the system is likely to be responsible. The two surveys of business and government perceptions illustrate how the search for responsibility is easily misdirected. Business owners repeatedly fault government officials for their arcane procedures and sometimes stubborn unwillingness to facilitate the process. Government officials, on the other hand, complain that businesses often fail to properly comply with their requirements. While some criticism may properly be directed at the private business sector, the government officials' criticisms often, in themselves, provide evidence of an unwillingness to listen to and work with businesses to facilitate private sector growth.

In regards to official visits and inspections by rural government officials, such visits and subsequent fines that may be levied sometimes represent a reasonable implementation of public policy, but the inspection and enforcement process represents another way that local governments can drive up the cost of doing business. Moreover, in local communities located far from the where oversight is provided by higher-ranking officials, the authority to inspect and levy fines can exceed the intent of the laws. In other instances, even the pursuit of regular enforcement of various regulatory codes may be more an exercise in the pursuit of side-payments pocketed by the inspectors.

It is often difficult to determine exactly where the line should be drawn between vigorous regulatory enforcement and predatory behavior, but even casual conversations with rural business owners suggest that this line is often crossed. To better understand exactly how the process of regulatory enforcement is perceived by local businesses, the survey asked respondents both about the regularity of visits (both frequency and the length of each visit) as well as the amount of financial payments (both formal fines and informal side-payments) that were solicited by local regulators and inspectors. The most burdensome aspect of this process for businesses appears to have been neither the problem of repeated visits nor the demand for payments under the table, but rather the high frequency with which fines are charged. With between one-fourth and one-half of certain inspections leading to fines, it seems clear that there is extremely poor compliance by the private sector and/or there is ambiguity in the legal code that leads to the common imposition of financial punishment.

Perhaps the most important form of official visits for larger businesses came from the social insurance office, and by labor inspectors who check to make sure that businesses are paying an appropriate amount into the social security fund. Social security department officials in rural areas typically inspect large businesses that employ permanent, long-term employees about once every two years. Smaller businesses tend to receive far fewer inspection visits, in part because they tend to employ short-term contract laborers, employers of whom are not required to pay social security. Only about half of large businesses surveyed reported these visits from social security department officials, but the formal fees assessed to three of the seven inspected firms totaled 1.3 million MNT. Only about 15% of the small business sample reported visits from these officials, but five of the six inspected companies were made to pay fines, including the single largest fine reported in this survey (2 million MNT), by the largest firm in the small business sample. In all, the total amount reported collected by social insurance inspectors exceeds the intake of every other local government agency except the tax department.

Constraints on expansion. One reason rural businesses may not be dynamic, achieving positive growth each year in production, employment or sales, is that it may not be possible or profitable to become larger. For example, the survey of larger businesses (with an average employment level of just 12.5 workers) found that about 86% of the respondents worry that a growing business would bring greater scrutiny from the government. Indeed, the survey (as mentioned above) underscores the high frequency with which fines are charged after official visits and inspections, a fact that may deter, rather than encourage, expansion and re-invstment among rural businesses. Nearly half of smaller firms worry that "trouble-makers or other pressure groups (such as police or politicians)" would harass them for additional payments if they grew larger. Threats from official or unofficial sources appear to represent one factor that discourages rural businesses from growing in Uvurhangai.

For any business to plan for growth – especially one operating in rural Mongolia – it needs to have regular access to accurate information about the rules that govern its business activities. In Uvurhangai, this information seems to be scarce. The vast majority of all rural businesses (73% of small enterprises and 83% of the larger firms) complained about poor access to information regarding relevant laws and regulations. Similarly, the majority of businesses (73% of small enterprises and 60% of the larger firms) feel that adequate information about tax requirements is not provided, and roughly the same proportion (73%) of small businesses interested in tapping export markets felt that there is not sufficient information provided regarding the regulations that govern the export process. In these cases, it does not matter so much where the information originates, as it is clear that no local institution is accepting responsibility for facilitating private sector growth by making the information available and encouraging its use.

Conclusions

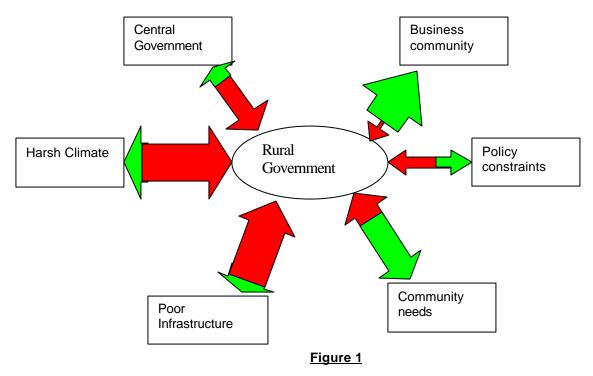
During this initial study, rural government officials repeatedly expressed the desire to do the best job possible, yet at once admit struggling to function effectively in an environment characterized by a variety of external constraints and pressures. These forces and factors include a dearth of financial and skilled human resources, myriad central government laws, provisions and programs to be aware of and follow, remote location, and the harsh and unpredictable weather. Moreover, their understanding of what rural businesses want and need in order to flourish is not always as sophisticated as they themselves believe it should be. And yet while local governments bemoan their lack of resources and authority, a closer inspection of the evidence from Uvurhangai suggests that there exists considerable scope for proactive engagement by government to create more authority and autonomy for themselves, and in turn to create and sustain a more predictable, conducive environment for the local business community. To have a real impact, however, this proactive engagement must occur on three fronts at once and in iterative ways: rural government horizontally across its own departments; rural government collaboratively with rural businesses; and rural government vertically with central government.

The rural business community seems to view rural government somewhat more critically than these officials view themselves. Businesses often (but not always) describe local public institutions as not providing high quality services, sometimes erecting obstacles to their pursuit of normal business activities, and generally not listening to them regarding their concerns. Given that the local business community in Uvurhangai assesses the performance of government to be relatively poor, it is important to explore the relationship between rural business owners and rural government officials. One factor contributing to this poorly perceived relationship is the absence of any effective formal channels for interacting with government institutions as a group. Less than one-fourth of all small businesses belong to any kind of trade association, and only one-third of those (or less than 8% of all small businesses) actively communicate their problems to local government officials. Although about half of larger business are members of a chamber of commerce or trade association, a much smaller fraction (28.6%) actually use that mechanism to take their problems to government. In other words, only 15% of the larger businesses surveyed actually work with each other and with the government to address their problems.

This study asked a variety of supporting and proxy questions in order to elicit salient data to answer the core question. However, the exercise of conducting this study seems to have made the core question itself more poignant than ever. That is, to ask whether rural government is a factor in rural business development and if so, in what ways, preassumes that this notion is not only plausible, but appropriate and necessary. The truth is, however, this notion does not seem natural, or logical, to most of the rural government officials and business owners and operators surveyed. To make this point clearer, it is useful to look at what happened while conducting the study.

Given the tight timing constraints of this study, the small TAF research team needed to act quickly, methodically and in parallel. And despite being a significant challenge, the

process of gathering and analyzing all the data so quickly had an unexpected benefit. Normally, a small research team would design and administer one survey at a time, or larger teams would conduct separate surveys but over longer periods of time, and probably with a tighter focus on one target group. But in this instance, the TAF team surveyed, concurrently, many parties involved in or connected to the same problem, each with their own perspective and viewpoint. Through this process, the team began to see things in a new light. What started to emerge was an insight into how rural governments, vis-à-vis rural businesses, think and act. This diagram illustrates how rural government seems effectively trapped by forces pressing in on all sides.

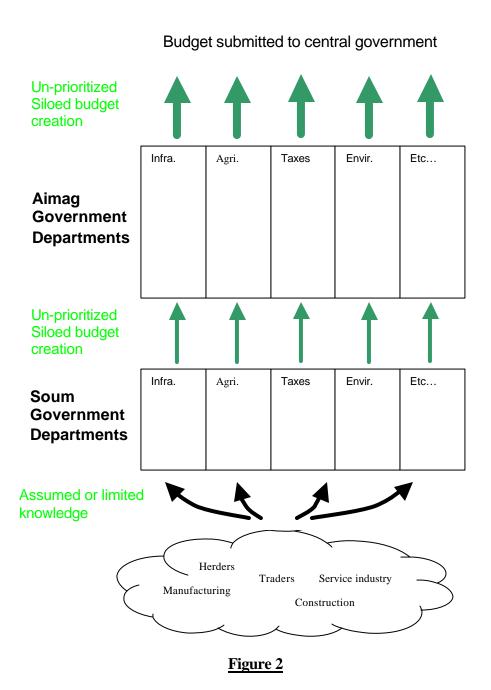


The size and direction of the arrows represent the amount of influence on or by rural government and the impact it has, or more importantly can have, in the opposite direction.

But this does not tell the whole story. In fact, a critical underlying constraint on rural government is its lack of financial planning and management. This constraint is a direct function of rural government's failure to capitalize on opportunities (given to it by central government!) to take more control over – that is, to strategically create more official authority and effective autonomy in regards to – its own financial planning and management. This constraint is further burdened by two other key factors. The first is the siloed nature of both rural and central government agencies and divisions. The second is a failure by rural government to pro-actively listen to the needs and priorities of rural businesses, and likewise a failure by rural businesses to better understand the potential supporting role that rural government can play with their input and solidarity.

The conclusion of this report is that rural governments today cripple their own potential to better support rural business development. They do so by failing to communicate internally and with local businesses, as well as by failing to think and act strategically

when responding to central government requests for input for new government programs and policies. The diagram below illustrates how soum and aimag governments presently operate in terms of internal and external communications and information flows regarding government programs and policies that directly impact rural business development.



The final diagram illustrates the change required to effectively address the problems described above and herein. This change is likely to result in rural governments' realization of the untapped potential for more official authority and effective autonomy. This in turn will focus the limited resources and funding that rural governments have toward making a greater positive impact on the operating environment for rural business development.

Budget submitted to central government

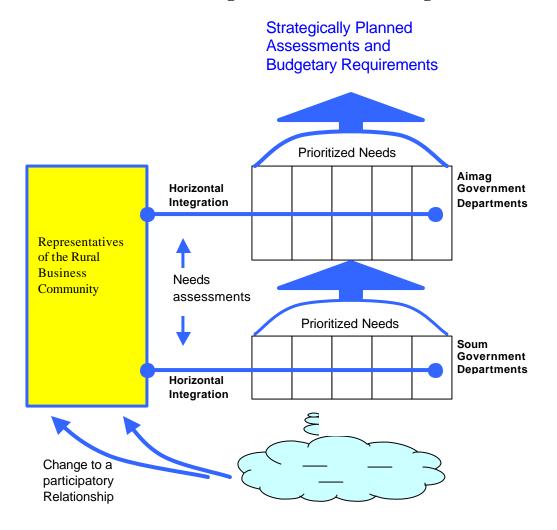


Figure 3